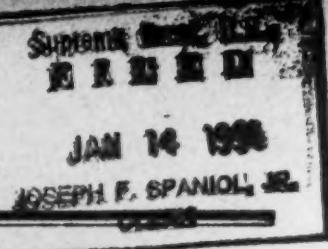


(2)
No. 90-772



In the Supreme Court of the United States
OCTOBER TERM, 1990

STATE OF OHIO, DEPARTMENT OF TAXATION, ET AL.,
PETITIONERS

v.

INTERNAL REVENUE SERVICE

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held with respect to the proceeds from the sale of the debtor's liquor licenses that the claim and lien of the United States for withheld income taxes and employment taxes assessed against the debtor prior to the filing of its petition for bankruptcy took priority over the claim of the State of Ohio for delinquent sales taxes.

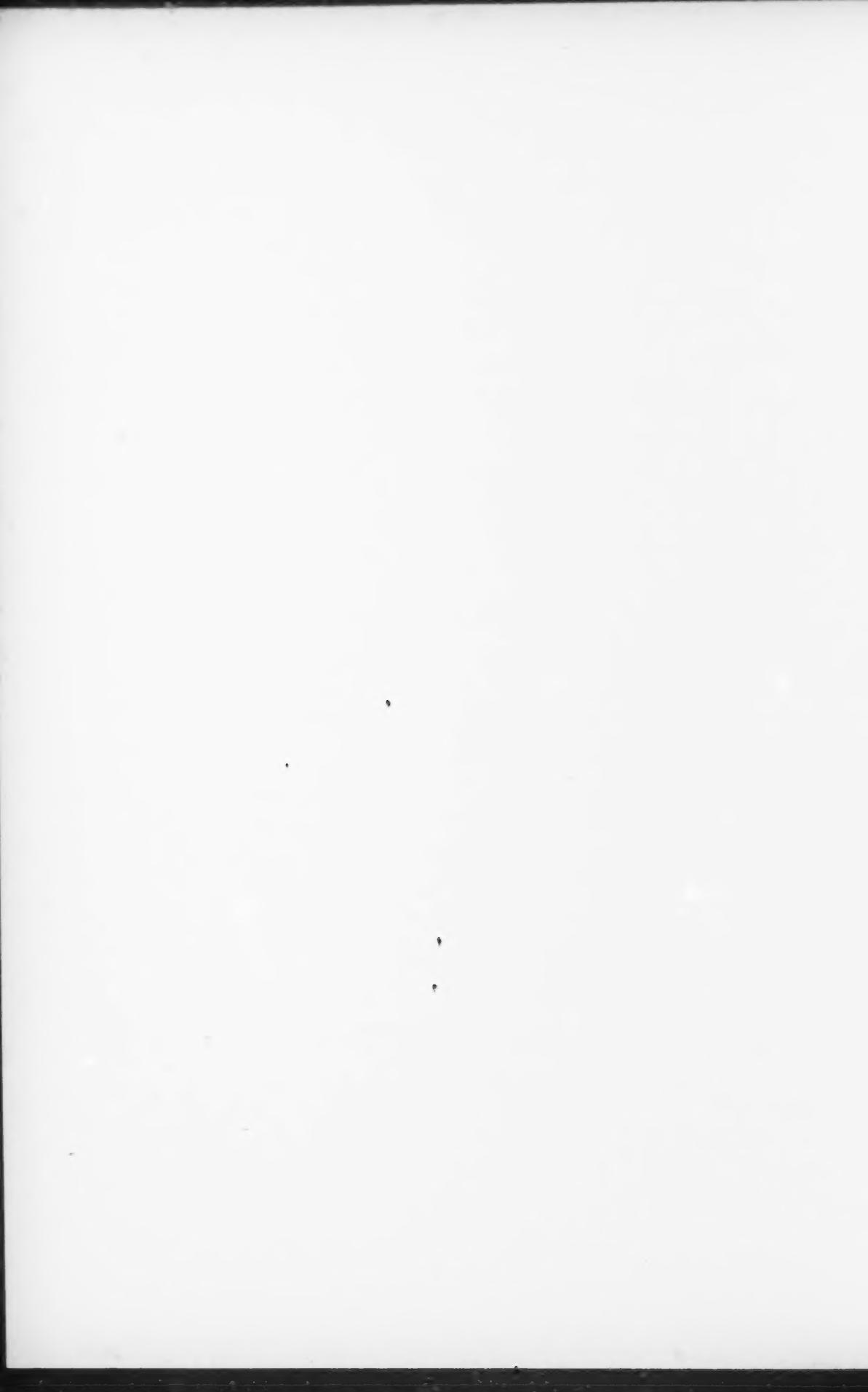


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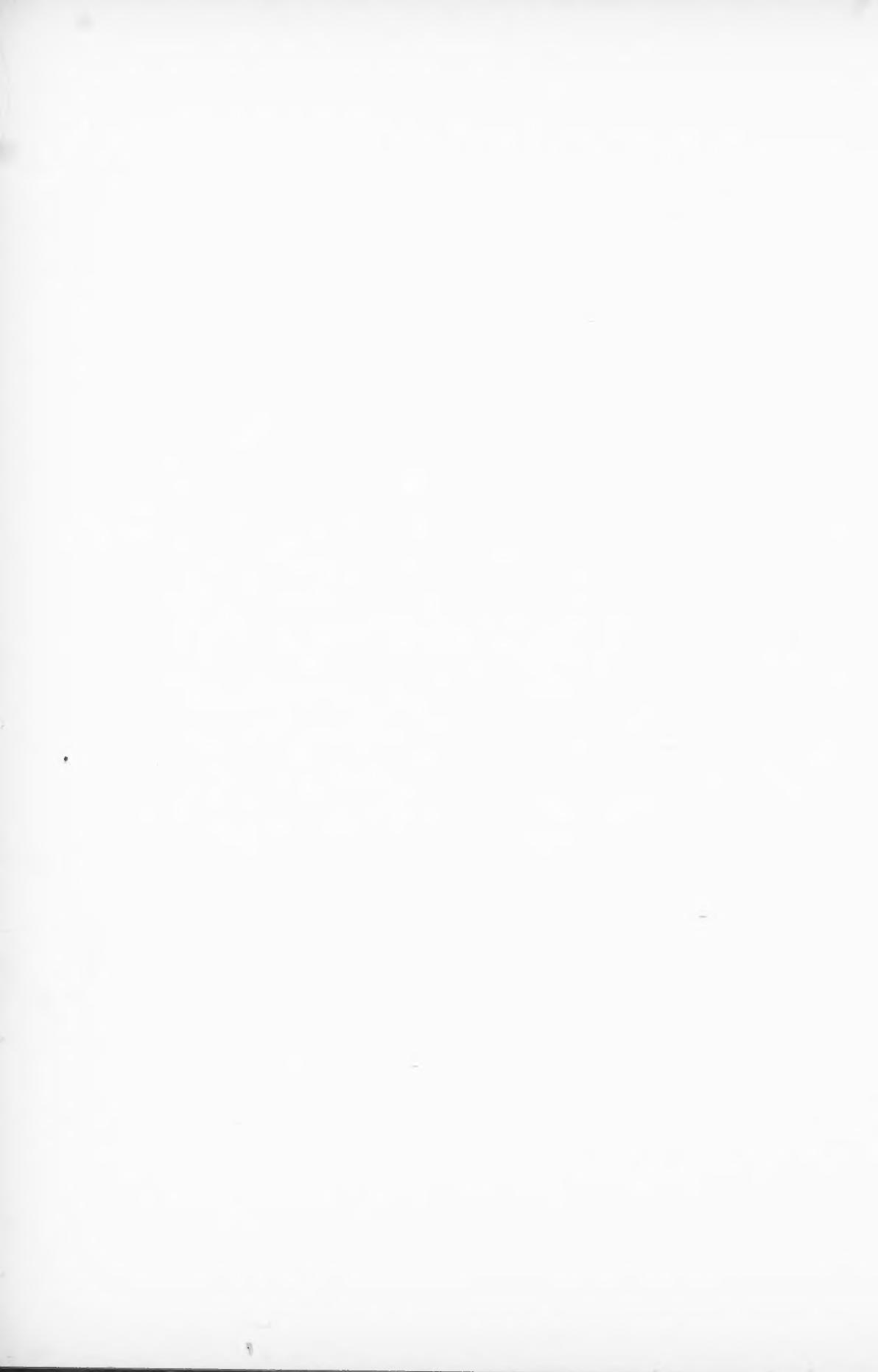
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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A22) is reported at 911 F.2d 1168. The opinion of the district court (Pet. App. A23-A27) is unreported. The opinion of the Bankruptcy Court (Pet. App. A28-A35) is reported at 86 Bankr. 937 (1988).

JURISDICTION

The judgment of the court of appeals was entered on August 13, 1990. A petition for rehearing was denied on September 28, 1990. The petition for a writ of certiorari was filed on November 13, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

(1)

STATEMENT

On July 8, 1987, Terwilliger's Catering Plus, Inc. (Terwilliger's) filed a bankruptcy petition under Chapter 7 of the Bankruptcy Code. At the time of that filing Terwilliger's held a liquor license issued by the Ohio Department of Liquor Control. The United States filed a proof of claim stating that the debtor was indebted to it in the amount of \$36,178.55* for unpaid withheld employee income taxes, FICA taxes, FUTA taxes, and interest and penalties, all of which had been assessed on various dates between December 1985 and September 1986. As a result of the assessed and unpaid federal taxes, a federal tax lien had attached to all of the debtor's property pursuant to Section 6321 of the Internal Revenue Code. Notices of the federal tax liens had been filed on April 14, 1986, and December 9, 1986. The State of Ohio also filed a proof of claim based upon unpaid pre-petition sales tax liabilities of \$13,866.43 incurred between 1984 and 1986. The amount and validity of the several tax claims, the federal tax liens, and the filed notices are undisputed. Pet. App. A2-A3.

The trustee, naming the Internal Revenue Service and state authorities as defendants, sought permission from the Bankruptcy Court to sell the debtor's liquor license free and clear of liens, and sought an order preventing the State from interfering with the sale and requiring it to complete the transfer of the liquor license. Because Ohio Rev. Code Ann. § 4303.26 (Anderson 1989) (see Pet. App. A44) conditions transfer of a liquor license upon payment

* The \$336,734.98 appearing at Pet. App. A2 is a typographical error. See Pet. App. A23, A29, and 911 F.2d at 1169.

of taxes owed by the owner, the State of Ohio claimed a prior right to any proceeds of the sale. Pursuant to an agreement between the trustee, the United States, and the State of Ohio, the liquor license was to be sold with the respective rights of the parties attached to the proceeds. The license was sold for \$8,921. Pet. App. A3, A29.

The State of Ohio argued in the alternative (1) that the liquor license was not property to which the federal tax lien could attach or which would become part of a bankruptcy estate, and (2) that if the license was part of the bankruptcy estate, it was taken with the restrictions imposed by the issuer in Ohio Rev. Code Ann. § 4303.26, *i.e.*, that it could not be transferred until the State's tax claims against the holder were satisfied. Pet. App. A3, A8, A30. The bankruptcy court rejected both positions and awarded the proceeds of the sale to the United States. Pet. App. A28-A35. The district court affirmed. Pet. App. A23-A27.

A divided panel of the court of appeals affirmed the decision of the district court. The court invoked this Court's decision in *Aquilino v. United States*, 363 U.S. 509 (1960), holding that although state law determines what interests a debtor or taxpayer has, federal law determines whether those state-created interests constitute property or rights to property to which the federal tax lien can attach, and determines also "the priority of competing liens asserted against the taxpayer's 'property' or 'rights to property.'" 363 U.S. at 514. Although Ohio courts had refused to label the rights granted to the holder of a liquor license as "property rights," the court of appeals held that since the license had beneficial value for the holder, and could be transferred or

sold, it constituted property subject to the federal tax lien. In so holding, it agreed with the decision of the Third Circuit in a similar case, *21 West Lancaster Corp. v. Main Line Restaurant, Inc.*, 790 F. 2d 354 (1986). Pet. App. A3-A8.

The court further held that the restrictions on transfer of a liquor license imposed by Ohio Rev. Code Ann. § 4303.26, did not entitle the State's claim for taxes to priority over the federal tax lien. Those restrictions constituted only a collection device or an encumbrance in the nature of a common law lien. But that lien was not one that authorized the state to proceed against the property. Since the State's lien was thus enforceable only when renewal or transfer of the license was sought—and not at the time the federal tax assessment was made and notice filed—it was contingent and therefore inchoate at the time when the federal tax liens were perfected. Accordingly, pursuant to federal law, which is dispositive under *Aquilino*, the claim of the United States to the proceeds of the sale took priority over the claim of the State. Pet. App. A8-A19.

ARGUMENT

The decision of the court of appeals is correct and is not in conflict with any decision of this Court or any other court of appeals. Further review by this Court is therefore not warranted.

1. Petitioners' assertion (Pet. 5-12) that the decision of the court of appeals conflicts with the decisions of this Court in *Hyde v. Woods*, 94 U.S. 523 (1877), and *Board of Trade v. Johnson*, 264 U.S. 1 (1924), is mistaken. *Woods* and *Johnson* involved, respectively, memberships in the San Francisco Stock Exchange and in the Chicago Board of Trade, claimed by a trustee in bankruptcy for the

debtor's estate in each case. In *Woods*, the rules of the organization granting membership provided that in case of sale of a membership, the proceeds would go first to the claims of other members. In *Johnson*, the rules provided that a membership could not be sold if other members held claims against the owner. See 264 U.S. at 11. In each case the trustee claimed the membership unencumbered by the claims of members, who asserted that the membership was not property and therefore not part of the bankruptcy estate.

In *Woods* and *Johnson*, this Court, applying federal standards that—at least in *Johnson*—were inconsistent with state court decisions (see 264 U.S. at 8), held that the exchange memberships were property subject to the claim of the trustee in bankruptcy. *Johnson*, 264 U.S. at 8-11; *Woods*, 94 U.S. at 524. The court of appeals in this case followed *Woods* and *Johnson* by holding that the liquor license here was also property subject to the claim of the trustee in bankruptcy. In *Woods* and *Johnson*, this Court then proceeded, however, to recognize the claims of members as “in some respects similar to the typical lien of the common law.” *Johnson*, 264 U.S. at 11 (explaining *Woods*). That, too, finds its parallel in this case, since the court of appeals here recognized that “[i]f the state's interest is to receive any protection in the case before us, it must qualify as a lien or similar security interest.” Pet. App. A13. At this stage of the analysis, however, the effect of a new element not present in the earlier cases—the federal tax lien—must be considered. As this Court held in *Aquilino*, the relative status of the federal and state liens is determined by federal standards. The court of appeals' decision (see Pet. App. A16-A19) that the federal lien must prevail over the

inchoate state lien does not conflict with any decision of this Court.

2. Petitioner contends (Pet. 12-14) that the Sixth Circuit's interpretation of the Ohio statute in this case conflicts with the Ninth Circuit's interpretation of a somewhat similar California statute in a series of four cases. Of course, the fact that the Sixth Circuit interprets an Ohio statute in a fashion arguably different from the Ninth Circuit's interpretation of a California statute (see Pet. App. A44) does not present a conflict among the circuits warranting review by this Court. The appropriate interpretation of Ohio and California statutes is a question answerable with finality only by the highest courts of each State.

In any event, it seems clear that, with a qualification noted below, there is no conflict here. Petitioner (Pet. 12) asserts conflict with a group of four Ninth Circuit decisions, but three of the four, including the two most recent, involve only an unrelated issue. As discussed above, the dispositive issue in this case is the priority of the federal tax lien, determined—as this Court has held it must be—by federal standards. No federal tax lien was involved in three of the four cases invoked by petitioner as in conflict.

In re Farmers Markets, Inc., 792 F.2d 1400 (9th Cir. 1986), held that despite the objections of California authorities the trustee in bankruptcy could sell the bankrupt's liquor license, but that *in the absence of congressional provision otherwise* (792 F.2d at 1403), the proceeds, or the necessary part thereof, should be applied as provided in Cal. Bus. & Prof. Code § 24049 (West 1985). The court held that the State's refusal to transfer the license violated the automatic stay, although not seriously enough to warrant sanctions. Whether, in the ab-

stract, the Ninth Circuit's characterization of the statutory provisions as "restrictions imposed on the debtor by its transferor" (792 F.2d at 1403) differs significantly from the Sixth Circuit's characterization of the Ohio statutory provisions as a "debt collection method" or "lien" (e.g., Pet. App. A13) is by no means clear, and, for present purposes, is irrelevant in the absence of a competing federal tax lien. *In re Professional Bar Co.*, 537 F.2d 339 (9th Cir. 1976), and *Meyer v. Bass*, 281 F.2d 728 (9th Cir. 1960), are similarly unrelated to the issue in this case. Each involved a suit by a trustee in bankruptcy to recover sums paid out from the proceeds of sale of a liquor license as a condition of its transfer. No tax lien was involved.

The court of appeals in this case did acknowledge (Pet. App. A18) that its decision appeared to be inconsistent with the decision of the Ninth Circuit in *United States v. California*, 281 F.2d 726 (1960), and declined to follow that case, which involved a federal tax lien subordinated to the State's claim to the proceeds of the bankrupt's liquor license. Yet, although the cases appear to be in some tension, the significant fact regarding *United States v. California* is that it was decided 21 days after this Court's decision in *Aquilino*, with no indication that the court was aware either of the *Aquilino* decision or even of the controversy that gave rise to that decision and to *United States v. Durham Lumber Co.*, 363 U.S. 522 (1960). Indeed, in contrast with settled doctrine that federal law determines both whether state-created interests constitute "property" (see *Aquilino*, 363 U.S. at 512-514; 21 *West Lancaster*, 790 F.2d at 356-358) and "the priority of competing liens asserted against the taxpayer's 'property' or 'rights to property'" (*Aquilino*, 363

U.S. at 514), the Ninth Circuit looked to state law to establish the priority of the State's claim to the proceeds from the bankrupt's liquor license. See 281 F.2d at 727.

In view of the inconsistency between the decision in *United States v. California* and this Court's decision in *Aquilino*, it is doubtful whether the Ninth Circuit would, in light of *Aquilino*, follow its earlier decision when a competing federal tax lien was involved. That doubt is, of course, enhanced by the fact, noted above, that in its recent *Farmers Markets* opinion, that court acknowledged (792 F.2d at 1403) that a federal statutory provision otherwise would override the provisions of the California statute on the transfer of liquor licenses. Until the Ninth Circuit, while acknowledging *Aquilino*, follows *United States v. California* and subordinates a perfected federal tax lien, we believe that there is no conflict with the decision of the Sixth Circuit in the present case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1991